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No. 227

In the Supreme Court of the United States

OCTOBER TERM, 1947

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

JOSEPH SUNNEN

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE PETITIONER

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OPINIONS BELOW

The opinion of the Tax Court (R. 62–72) is reported at 6 T. C. 431. The opinion of the Circuit Court of Appeals (R. 92–101) is reported at 161 F. 2d 171.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on April 28, 1947. (R. 101–102.) The petition for a writ of certiorari was filed on July 28, 1947, and was granted on October 13, 1947. (R. 103.) The jurisdiction of this Court rests on Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

Mr. Sunnen is an inventor who had obtained certain patents; he is also the owner of 89% of the stock of a manufacturing corporation, and his wife owns 10% of the stock. In exchange for a specified royalty, he gave the corporation non-exclusive licenses to manufacture and sell devices covered by the patents. The licenses were cancellable by either party upon giving appropriate notice. He assigned his interest in the royalty agreements to his wife. The Tax Court held that he was not relieved of tax with respect to the royalties paid to his wife under the assignments in the taxable years 1937–1941 (except for a small amount in 1937 held excludible under the doctrine of *res judicata*).

1. The principal question presented is whether the Circuit Court of Appeals was warranted in holding that Mr. Sunnen could effectively avoid the tax upon the royalties through such assignments.

2. A subsidiary question that may be raised by the taxpayer is whether an earlier decision of the Board of Tax Appeals (involving a similar royalty agreement and assignment) should be treated as conclusive of the entire controversy under the doctrine of *res judicata*.

STATUTES AND REGULATIONS INVOLVED

These are set out in the Appendix, *infra*, pp. 30–32.

STATEMENT

The material facts in this case were stipulated (R. 25–50) and were so found by the Tax Court (R. 63). Their statement by the Tax Court (R. 63–69) may be summarized as follows:

During the taxable years, 1937–1941, Sunnen Products Company, a Missouri corporation, was engaged in the manufacture and sale of patented grinding machines and other tools. The taxpayer, a resident of Clayton, Missouri, held 1,780 out of a total of 2,000 shares of the Company's outstanding stock; his wife, Cornelia Sunnen, held 200 shares; and others connected with the Company held the remaining 20 shares. (R. 63–64.) The Company's board of directors consisted of five members, including the taxpayer and his wife, and a vote of three was required to take binding action. (R. 66.) It was stipulated that the directors were elected by the stockholders annually. (R. 31–32.)

In 1927, 1931 and 1939 the taxpayer, an inventor, had applied for patents on a cylinder grinder device, a pinhole grinder device, and a crankshaft grinder device, and subsequently patents were issued to him. He remained the owner of these patents through the year 1941. In 1939 the taxpayer applied for a patent on another crankshaft grinder device, and remained the owner of the application through the year 1941. (R. 64.)

By a written agreement dated January 10, 1928, the taxpayer granted the Company the right, license and privilege to manufacture and sell in the United States and foreign countries the "cylinder grinders" device, on which he had applied for a patent. In consideration of this license the Company agreed to pay to the taxpayer a royalty equal to 10% of the gross sales price of the device as it was "manufactured, sold and collected for." Both parties were given the right to cancel the license or to cease manufacturing thereunder, without liability, upon six months' notice in writing to the other party. In the absence of cancellation, the agreement was to continue in force for ten years. (R. 64–65.) Upon the expiration of this agreement in 1938, a renewal agreement with substantially the same terms was executed pursuant to which the Company was licensed to manufacture and sell the cylinder grinder for the balance of the life of the patent, i. e., until December 4, 1951. (R. 66.)

Similar licensing agreements, except that the period for serving notice of cancellation was one year instead of six months, were executed by the taxpayer and the Company on December 5, 1931, with respect to the pinhole grinder device, and on June 20, 1939, with respect to the two crankshaft grinder devices. The Company was authorized by its board of directors to execute each of the license agreements. (R. 64, 65, 66.)

No notices of cancellation were given and all the licensing agreements remained in effect throughout the taxable years 1937–1941, inclusive, in accordance with their terms. (R. 66.)

On January 8, 1929, the taxpayer assigned to his wife, "all my rights, title and interest in and to the Royalty which shall accrue hereafter to me" upon the royalty contract of January 10, 1928, with respect to the cylinder grinder device. On January 15, 1929, he advised the Company of the assignment. (R. 66–67.) On December 21, 1931, he executed a further assignment which recited that the Commissioner of Internal Revenue had raised some question as to the sufficiency and completeness of the previous assignment, and in which he confirmed the previous assignment, and assigned to his wife (R. 67–68)—

> all of my right, title and interest in and to said royalty contract of January 10, 1928 between myself and said Sunnen Products Company, relating to the manufacture of the cylinder grinder described in said royalty contract, for the calendar year 1931, particularly. And I hereby state that the royalties accruing under said royalty contract have heretofore been and are hereafter the sole and exclusive property of the said Cornelia Sunnen, and hereby declare that said royalties shall be paid to the said Cornelia Sunnen or to her order, and that she shall have the sole right to collect, receive, receipt for, retain or sue for said royalties.

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The taxpayer also executed written assignments, similar in form and substance to the assignment of December 21, 1931; purporting to assign all of his right, title, and interest in and to the royalty contracts with respect to the pinhole grinder and the two crankshaft grinders, and to the renewal royalty contract made in 1938 with respect to the cylinder grinder. In each case he notified the Company of the assignments. (R. 68).

All the assignments were without consideration and were made as gifts to taxpayer's wife. The gifts made after 1932 were reported by taxpayer for gift tax purposes. (R. 68.)

In 1937 the Company paid to taxpayer's wife, pursuant to the assignments, royalties on the 1928 cylinder grinder contract in the amount of $4,881.35 and on the pinhole grinder license contract royalties of $15,518.68. In the taxable years 1938–1941, inclusive, no royalties were paid on the 1928 cylinder grinder contract, but royalties were paid to taxpayer's wife on the 1938 renewal cylinder grinder contract and on the pinhole and crankshaft grinder contracts in the total amounts of $17,318.80 in 1938, $25,243.77 in 1939, $50,492.50 in 1940, and $149,002.78 in 1941. (R. 68.)

The taxpayer's wife included in her income tax returns all of the royalties paid to her in the taxable years in which she received them. She paid income taxes thereon, which have not been refunded to her. (R. 69.)

The taxpayer in his returns for 1937, 1938, 1939, 1940, and 1941, reported net income of $30,616.03, $36,787.82, $42,229.35, $48,846.92, and $60,570.28, respectively. (R. 13–17.)

In a previous proceeding involving the taxpayer's income tax liability for the years 1929, 1930, and 1931, the Board of Tax Appeals held that the taxpayer was not taxable on the royalties paid to his wife in those years under the original license agreement of January 10, 1928, with respect to the cylinder grinder device. (R. 53–62.) It was stipulated that this opinion, and decisions rendered pursuant thereto, might be considered in this case to the same extent as if introduced in evidence. (R. 69.)

Upon these facts the Tax Court, one judge dissenting, held that all of the royalties paid to taxpayer's wife in each taxable year under the license agreements were in fact taxable income of the taxpayer, with the exception that the royalties of $4,881.35 paid in 1937 under the original cylinder grinder license contract were held to be excludible from his income in that year. This was on the theory that the principle of *res judicata* prevented treating these royalties as taxable income of the taxpayer in 1937, since in the former decision the Board had held that royalties paid under the same contract in the years 1929, 1930, and 1931, were not income of the taxpayer. (R. 69–72.)

The taxpayer appealed to the Circuit Court of Appeals, contending (1) that the Tax Court erroneously decided that the royalties paid to his wife in the taxable years under the license agreements constituted taxable income in fact to him; and (2) that the Tax Court erred in failing to hold that the former decision of the Board was *res judicata* that none of the royalties were taxable income to him in any taxable year. (R. 73–80.) The Commissioner also appealed to the Circuit Court of Appeals from the portion of the Tax Court's decision which was adverse to him, contending that the Tax Court was not estopped by the doctrine of *res judicata* from including the royalties of $4,881.35, paid under the 1928 licensing contract, in taxpayer's income for 1937. (R. 80–82.)

The Circuit Court of Appeals reversed the Tax Court's decision on the merits in the taxpayer's appeal, holding that the royalties paid to the taxpayer's wife in the taxable years were not income to the taxpayer. (R. 92–99.) In the Commissioner's appeal, the Circuit Court of Appeals affirmed the Tax Court, holding that the doctrine of *res judicata* prevented inclusion in taxpayer's income of the royalties of $4,881.35 paid in 1937 under the original cylinder grinder royalty contract. (R. 99–100.) In view of its decision on the merits, it was unnecessary for the court to decide the question raised by the taxpayer as to

the applicability of *res judicata* to the other royalties paid in the taxable years. (R. 100–101.)

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

(1) In not holding that the royalties paid to the taxpayer's wife were in fact taxable income of the taxpayer.

(2) In substituting its view for that of the Tax Court and reversing the Tax Court's decision.

SUMMARY OF ARGUMENT

I

The basic question presented is whether the owner of a patent who has granted to his controlled corporation a non-exclusive and cancellable license to exploit it for a limited period, in consideration of royalties to be paid him, may, by assigning his interest in the license contract to his wife, shift to her the responsibility for income taxes on the royalties thereafter paid to her under the assignment. We submit that he cannot. The Tax Court correctly so held and specifically found that the royalties paid to the wife were in fact taxable income of the husband. The result thus reached was in accord with established principles. *Lucas* v. *Earl*, 281 U. S. 111; *Helvering* v. *Horst*, 311 U. S. 112; *Helvering* v. *Eubank*, 311 U. S. 122; *Harrison* v. *Shaffner*, 312 U. S. 579; *Helvering* v. *Clifford*, 309 U. S. 331; *Commissioner* v. *Tower*, 327 U. S. 280. We submit that the Tax

Court's decision should not have been reversed by the Circuit Court of Appeals.

The Circuit Court of Appeals failed to focus attention on the overall picture, the composite of the incidents of ownership and control that taxpayer retained. It treated the royalty agreements as the sole source of the income involved, and concluded that since the taxpayer had given away the source he could no longer be held accountable for the income therefrom. But the court erred in thus isolating the royalty agreements. In every real sense the inventions and the patents themselves, rather than the royalty agreements, were the underlying source of the income, and these the taxpayer retained for himself. Moreover, the license and royalty agreements were cancellable, and the taxpayer, as president, director, and majority stockholder of the corporation-licensee was in a position to control its policies and actions. Furthermore, since the licenses here involved were non-exclusive, the taxpayer as owner of the patents could have granted licenses to others (including licenses to any wholly-owned corporation that he might choose to organize for that purpose) and thus divert the business from the first licensee. In the circumstances, it cannot be said that the taxpayer made an outright gift to his wife, without reservations and without retention of control, so that she and not he would be accountable for the future income from the property.

If taxpayer had assigned the patent royalties alone, or the future income from the patents which he owned, he would clearly be taxable regardless of the assignment and we submit that no different result is justified here because he undertook to assign the royalty contracts themselves. It seems plain that the inventions and the patents, and not the royalty contracts, were the essential source of the income, and taxpayer retained ownership of such source. Moreover, even if the contracts be considered as the main source of the income, taxpayer's retained controls over them would still be enough to justify the tax.

Although this case involves legal principles of sufficient generality as ordinarily to render inapplicable the rule of *Dobson* v. *Commissioner*, 320 U. S. 489, those principles have already been established by the decisions of this Court in such cases as *Lucas* v. *Earl*, and the *Horst*, *Eubank*, *Shaffner*, *Clifford*, and *Tower* cases; accordingly, it would seem that the reasonable application of those principles by the Tax Court to the facts of this case should have been left undisturbed by the court below under the *Dobson* rule.

II

There is no basis for the application of *res judicata* here. The royalty agreements and assignments in this case are wholly separate and distinct from the royalty agreement and assignment involved in the earlier case. The principle of *res*

judicata is one that forbids inquiry into the truth and prevents the correct disposition of a controversy. It does not rest upon any statutory basis in federal tax cases, and is applied sparingly in situations involving different tax periods. It is not enough that the facts in the second period be "similar" to those involved in the prior adjudication; the courts have insisted that the liability in the second period must have its roots in the identical factual situation that was before the adjudicating body in the first proceeding.

A second reason why *res judicata* is inapplicable is that, after the decision of the Board of Tax Appeals in the earlier proceedings, a number of decisions of this Court (*e. g.*, in the *Horst, Eubank, Shaffner, Clifford,* and *Tower* cases) have been rendered which develop and make clear the underlying principles to be applied in cases of this type. And it has frequently been recognized in tax cases involving different periods that *res judicata,* which forecloses inquiry into the correct disposition of a controversy, is not operative where there have been authoritative intervening decisions with respect to controlling legal principles.

ARGUMENT

I

THE INCOME IN QUESTION IS TAXABLE TO THE ASSIGNOR

This case presents a situation where the taxpayer, an inventor, granted to a corporation of

which he was president and controlling stockholder nonexclusive and cancellable licenses to exploit for a limited number of years certain patents which he owned; and in return for that privilege the corporation agreed to pay to the taxpayer royalties amounting to ten percent of the gross sales. He then assigned his interest in the contracts to his wife and the question is whether he or she should be taxed upon the royalties paid by the corporation to the wife after the contracts were assigned.

The Tax Court ruled in the Commissioner's favor, and specifically concluded that the royalties were, in fact, taxable income of the husband. In so holding, the Tax Court relied upon its own prior decision in *Estate of Dodson* v. *Commissioner*, 1 T. C. 416, which presents a comparable situation. There the owner of a formula and trade-mark made a contract with a corporation (in which he owned 51% of the stock and his wife owned the remainder), under which it was given exclusive use of the formula and trade-mark for five years, renewable for a like period, and was to pay in return a royalty measured by a certain percentage of the net sales. Thereafter he assigned a one-half interest in the contract to his wife, retaining his full interest in the formula and trade-mark, and the question arose whether he thereby shifted to his wife the responsibility for the taxes on the income in the form of royalties which were thereafter paid. In holding the as-

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signor and not his wife accountable for the income in question, the Tax Court referred to the following language of this Court in *Harrison* v. *Schaffner*, 312 U. S. 579, 583–584:

> * * * we leave it to future judicial decisions to determine precisely where the line shall be drawn between gifts of income-producing property and gifts of income from property of which the donor remains the owner, for all substantial and practical purposes. Cf. *Helvering* v. *Clifford, supra.*

And then the Tax Court said (1 T. C. at page 423):

> Assuming in petitioner's favor, without deciding, that the royalty contract, which provided for reimbursement to decedent for the use of the trade-mark, was income-producing property, separate and distinct from the trade-mark itself, nevertheless, we are of the opinion that under the peculiar facts of the instant case decedent remained "for all substantial and practical purposes" the owner of the royalty contract and that the sole purpose intended and accomplished by the assignment of a one-half interest therein to his wife was to give her one-half of the income therefrom. See *Helvering* v. *Eubank, supra.* The only two parties to the royalty contract were decedent and a corporation which he controlled. Even after he had assigned a one-half interest in the contract to his wife, he and his controlled corporation could have modified or abrogated the contract at any time by

> mutual consent (which, under the circumstances, was equivalent to unilateral action on his part). There is nothing in the record here to suggest that this power was limited by any rights of creditors of the controlled corporation. By reason of this power over the contract, we conclude that for all substantial and practical purposes he remained the owner of the contract, and that the only substantial and practical result of the assignment in question was a gift to his wife of the income derived from the contract so long as decedent wished the contract to exist unmodified.

We submit that the Tax Court's decision is correct and blends harmoniously with well-settled principles of tax law.

It has become firmly established that the mere assignment of income does not relieve the assignor from tax. *Lucas* v. *Earl*, 281 U. S. 111; *Burnet* v. *Leininger*, 285 U. S. 136; *Helvering* v. *Horst*, 311 U. S. 112; *Helvering* v. *Eubank*, 311 U. S. 122; *Harrison* v. *Schaffner*, 312 U. S. 579; *United States* v. *Joliet & Chicago R. Co.*, 315 U. S. 44; *Commissioner* v. *Harmon*, 323 U. S. 44. And although it is generally true that the owner of property is no longer liable for tax upon the income therefrom after he has disposed of the property itself, he may still be accountable for the income if he has retained substantial incidents of ownership in the underlying property, particu-

larly where the income is merely reallocated within the family group. *Helvering* v. *Clifford*, 309 U. S. 331; *Hormel* v. *Helvering*, 312 U. S. 552; *Helvering* v. *Fuller*, 310 U. S. 69, 72, 76; *Helvering* v. *Stuart*, 317 U. S. 154, 167; *Commissioner* v. *Tower*, 327 U. S. 280; *Lusthaus* v. *Commissioner*, 327 U. S. 293.[1]

Tested by these familiar principles, the conclusion of the Tax Court in the instant case that the taxpayer is accountable for the income in question seems clearly correct.

If the taxpayer had assigned the patent royalties alone, or the future income from the patents which he owned, it could hardly be seriously contended that he would not be taxable under the foregoing principles. For this Court has long recognized that "an assignment, where the assignor continued to own the corpus, does not immunize him from taxation upon the income" (*Reinecke* v. *Smith*, 289 U. S. 172, 177), and a mere assignment of royalties where the assignor continues to own the patents would not relieve him of tax. We submit that the result is no different merely because the taxpayer attempted to cast the trans-

[1] Compare the decisions of this Court holding, in a wide variety of situations, that substance rather than form is the controlling consideration. *Commissioner* v. *Court Holding Co.*, 324 U. S. 331, 334; *Gregory* v. *Helvering*, 293 U. S. 465, 469–470; *Griffiths* v. *Commissioner*, 308 U. S. 355, 357; *Higgins* v. *Smith*, 308 U. S. 473, 477–478; *Minnesota Tea Co.* v. *Helvering*, 302 U. S. 609, 613; *Corliss* v. *Bowers*, 281 U. S. 376, 378.

action in the form of an assignment of the royalty *agreements* with his controlled corporation.

In the first place, he did not part with the inventions or the patents themselves. These he retained absolutely for himself, and they were in reality the ultimate source of the royalties.

In the second place, the license and royalty agreements were terminable upon notice of six months or one year (R. 65).[2] And the taxpayer, as owner of the patents and as president and owner of 89% of the stock in the corporation, was in a position to cancel the agreements in their entirety. The agreements explicitly provided for cancellation by *either* party "without liability for damages or breach" (R. 65), upon giving the required notice. The Circuit Court of Appeals improperly assumed (R. 97) that the powers of control were not substantial, on the theory that an attempted exercise of the powers would necessarily amount to a fraud on the corporation or on the taxpayer's assignee, which would be enjoined or would inevitably be defeated by the other directors of the corporation. But the taxpayer

[2] In view of the cancellation clauses, it seems unnecessary to note that, with only one exception, the licenses and royalty agreements were to run for ten years, a period which is characterized "as a relatively short term" in the Treasury regulations which undertake to spell out the extent of the rule in *Helvering* v. *Clifford, supra;* see also *Helvering* v. *Fuller*, 310 U. S. 69, 72, 76. Regulations 111, Sec. 29.22 (a)–21 (as added by T. D. 5488, 1946–1 Cum. Bull. 19, and amended by T. D. 5567, 1947–14 Int. Rev. Bull. 2).

might have caused a cancellation of the old contracts and have substituted new ones with more favorable terms to the corporation; surely there would be no fraud on the corporation in such case. Moreover, apart from the fact that she was a gratuitous assignee, Mrs. Sunnen would have no standing to complain of cancellation since her contractual rights were subject to the corporation's right to cancel upon notice without incurring liability. The license contracts did not require the corporation to manufacture and sell any particular number of devices, and did not specify minimum royalties payable (R. 33–34, 36–37, 39–41, 43–44). Thus, they did not guarantee that the licensor or his assignee would receive a minimum, or indeed any, royalties from the licensee. Even if it is assumed, despite the apparently harmonious family relationship, that the taxpayer's wife as a director would vote contrary to his wishes, it may not be assumed that the other directors were not amenable to his will, particularly since the directors were elected annually by the stockholders (R. 31–32), and a recalcitrant director could thus be removed by the taxpayer, the controlling stockholder.

In the third place, the licenses given by Mr. Sunnen to the corporation were not exclusive (R. 65). As owner of the underlying patents, he would have been within his rights in granting licenses to other corporations (which might be wholly owned by himself) and the business that

would otherwise go to this corporation might thus be diverted to the new corporations. *Western Electric Co.* v. *Pacent Reproducer Corp.*, 42 F. 2d 116 (C. C. A. 2), certiorari denied, 282 U. S. 873; Amdur, *Patent Law and Practice* (1935), Chap. XII, Sec. 14, pp. 571–572; 2 Walker, *Patents* (Deller's ed., 1937), Sec. 366, pp. 1459, 1462.

Plainly, this case involves merely an anticipatory arrangement for reallocation of income within the family group, and is governed by such decisions as *Lucas* v. *Earl*, 281 U. S. 111; *Helvering* v. *Horst*, 311 U. S. 112; *Helvering* v. *Eubank*, 311 U. S. 122; *Harrison* v. *Schaffner*, 312 U. S. 579; *Helvering* v. *Clifford*, 309 U. S. 331; *Commissioner* v. *Tower*, 327 U. S. 280; and *Lusthaus* v. *Commissioner*, 327 U. S. 293. In no real sense can this case be regarded as involving a complete disposition of property so that the transferee rather than the transferor becomes accountable for tax on the income therefrom. And *Blair* v. *Commissioner*, 300 U. S. 5, relied upon by the taxpayer, has been explained by this Court as resting upon such basis. See *Harrison* v. *Schaffner*, 312 U. S. 579, 582.

In reversing the Tax Court, the court below erroneously focused upon the royalty contracts, treated them as the source of the income, and concluded that since the taxpayer had given the contracts away he could no longer be charged with tax upon the royalties themselves. But the court below was not warranted in thus isolating the

royalty agreements. They were part of a larger picture, in which the taxpayer continued to own the underlying inventions and patents and in which he retained most effective control over the royalty and license agreements. By exercising his legal rights, he could have diminished or curtailed entirely the income payable to his wife under the assignments, and the result would not in any sense have constituted any actionable fraud upon her.

Even in the absence of such sweeping controls as were in fact retained by the taxpayer, the court below would not have been justified in treating the royalty contracts as the crucial source of the income. It may be assumed that a royalty contract is property, just as a lease is property. Cf. *Hort* v. *Commissioner,* 313 U. S. 28, 31. But the inventions and the patents themselves constitute the property that is the underlying source of the royalty income. The royalty contracts are merely the media selected by the owner of the patents to regulate the flow of income. And it seems plain that a taxpayer who retains ownership of a patent cannot by the simple expedient of assigning the royalty contract thereby escape taxes on income that he would be required to pay had he merely assigned the future royalties.[3] Cases of this

[3] The court below made the broad statement that the "rule seems to be established that a royalty contract is the producing source of the royalty income and that such income is taxable to the assignee," citing seven cases as authority (R. 95). The only one of them which involved an assigned patent roy-

type are not to be decided upon the basis of such "attenuated subtleties." *Helvering* v. *Horst*, 311 U. S. 112, 120; *Lucas* v. *Earl*, 281 U. S. 111, 114.[4]

In the light of the foregoing considerations, we submit that the court below was clearly wrong in concluding that the taxpayer made a completed gift, without reservations and without retention of control, which would shift the incidence of the

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alty contract is *Nelson* v. *Ferguson*, 56 F. 2d 121 (C. C. A. 3), certiorari denied, 286 U. S. 565, a decision which seems unsound in the light of subsequent decisions of this Court. The taxpayer in *Helvering* v. *Eubank*, 311 U. S. 122, unsuccessfully placed heavy reliance upon it. In any event, however, the inventor in the *Nelson* case assigned the patent itself to a corporation in which he was apparently only an employee, in circumstances quite unlike those present here.

[4] Similarly in the case of assignment of rents from real estate, we think that the owner of the real estate remains liable for tax upon the rents, whether the transaction takes the form of a mere assignment of the rents, or of an assignment of the lease, particularly where the lease is for a short term. The distinction adopted in *Lum* v. *Commissioner*, 147 F. 2d 356 (C. C. A. 3) between the two types of assignments is, we submit, unsound.

The illustration given in *Helvering* v. *Horst*, 311 U. S. at 119 with respect to rents from a leasehold, refers, we think, merely to an assignment of his entire interest by the owner of only a leasehold. Certainly, the Court was not considering the situation whereby an owner of property was attempting to deflect the rents through the device of assigning the lease, while at the same time retaining the real estate itself. Indeed, the tenor of the opinion as a whole would forbid the conclusion that a distinction is to be drawn between the assignment of rents for a specified period, on the one hand, and an assignment of the lease for the same period, on the other hand, so long as the assignor continues to own the property that produces the income.

tax. Accordingly, it is unnecessary to determine whether its appellate review was restricted by *Dobson* v. *Commissioner*, 320 U. S. 489. In a sense, the case involves a legal principle of general application, based upon a number of judicial decisions, to the effect that the owner of property (in this case, patents) may not avoid tax by deflecting the income therefrom "by anticipatory arrangements and contracts however skilfully devised" (*Lucas* v. *Earl*, 281 U. S. at 115). But that is a generalizing principle which has already been established by the decisions of this Court. And since that principle was correctly recognized by the Tax Court, it would seem that its application to the facts of this case should have been left undisturbed by the court below.

II

THE DOCTRINE OF RES JUDICATA IS INAPPLICABLE HERE

In the Tax Court the taxpayer contended that an earlier decision of the Board of Tax Appeals (rendered in 1935) relating to royalties paid in the years 1929–1931, favorable to him, was conclusive of the present controversy under the doctrine of *res judicata*. The present case involves the years 1937–1941, and of the total of over $260,000 in royalties paid during this period (R. 68), only $4,881.35 was paid (in 1937) under the contract that was involved in the prior proceeding. The remaining royalties were paid

under entirely separate, although similar, contracts, and the great bulk thereof related to wholly different patents that were not in any way involved in the earlier case.

The Tax Court held that the doctrine of *res judicata* did not apply, except as to the $4,881.35 in royalties paid in 1937 under the original contract. Both the taxpayer and the Commissioner appealed. The court below affirmed the Tax Court on the Commissioner's appeal (R. 99–100), but found it unnecessary to consider the issue of *res judicata* on the taxpayer's appeal, since it had concluded that he was not taxable in any event (R. 100–101). We do not here bring into controversy the propriety of the action of the court below on the Commissioner's appeal; however, since the taxpayer, as respondent, may renew his contention as to *res judicata* in order to seek to support the judgment in his favor on that ground, we shall state briefly our views on this issue.[5]

[5] The Government preserved the point as to the $4,881.35 payment in its specification of errors in the petition for certiorari (p. 11), but made it clear that it was not one of the grounds for granting certiorari. In the circumstances, it seems desirable not to press that minor point here since it might tend to becloud the issue on the merits which was the only reason for seeking certiorari. We shall discuss the taxpayer's *res judicata* point only because he, as a respondent, is entitled to raise it; but even as to that point, this Court may prefer, in its discretion, not to consider the matter, and leave it for further consideration by the court below, which has not yet passed upon it. Cf. *Commissioner* v. *Munter*, 331 U. S. 210, 216–217; *United States* v. *Ballard*, 322 U. S. 78, 88.

The earlier proceeding before the Board of Tax Appeals dealt with Mr. Sunnen's tax liability for the years 1929–1931. The Commissioner in no way seeks to disturb the judgment entered for those years. There was originally considerable doubt whether the doctrine of *res judicata* could apply in federal tax situations other than attempts to relitigate the identical tax liability disposed of in the prior litigation, particularly since no such concept is spelled out in the revenue laws. But, this Court held in *Tait* v. *Western Md. Ry. Co.*, 289 U. S. 620, that the doctrine applies as to taxes for different years,[6] where the liability is based upon an identical factual situation. (In the *Tait* case, the issue on the merits involved the deductibility of amortized bond discount with respect to the identical bond issues which had been the subject of prior litigation.) However, it is clear that the rule of the *Tait* case is subject to strict limitations (cf. *Blair* v. *Commissioner*, 300 U. S. 5, 8–9), and there are at least several reasons why it is inapplicable here.

1. The principle of *res judicata* does not apply

[6] The Court has refused similarly to extend the doctrine of *res judicata* in cases involving the customs laws (*United States* v. *Stone & Downer Co.*, 274 U. S. 225), although that result seems to have been explained in the *Tait* opinion chiefly on historical grounds. See 289 U. S. at 625. And, in other instances, the Court has shown considerable reluctance to extend the concept of *res judicata*. Cf. *Federal Trade Commission* v. *Raladam Co.*, 316 U. S. 149; *United Shoe Mach. Co.* v. *United States*, 258 U. S. 451.

in this case because the facts and issues here are not identical with the facts and issues in the earlier case. This is not a case where, as in the *Tait* case, 289 U. S. 620, 626, "all the facts" in the later case were before the adjudicating body in the prior case. Where the question in issue, in suits covering different periods of time, is dependent upon facts existing in the two respective periods, it has been frequently held that judgment entered in one suit is not conclusive in a second suit, even though the proof shows that the relevant facts are "similar" or "substantially the same." *Engineer's Club of Phila.* v. *United States,* 42 F. Supp. 182, 187 (C. Cls.), certiorari denied, 316 U. S. 700, rehearing denied, 317 U. S. 705; *Snyder* v. *Commissioner,* 73 F. 2d 5, 6 (C. C. A. 3), affirmed on grounds other than *res judicata,* 295 U. S. 134; *Henricksen* v. *Seward,* 135 F. 2d 986 (C. C. A. 9); *Stoddard* v. *Commissioner,* 141 F. 2d 76, 79–80 (C. C. A. 2); *Monteith Bros. Co.* v. *United States,* 142 F. 2d 139 (C. C. A. 7); *Commissioner* v. *Netcher,* 143 F. 2d 484 (C. C. A. 7), certiorari denied, 323 U. S. 759; *Corrigan* v. *Commissioner,* 155 F. 2d 164 (C. C. A. 6); *Duquesne Club* v. *Bell,* 42 F. Supp. 123 (W. D. Pa.), reversed on other grounds, 127 F. 2d 363 (C. C. A. 3), certiorari denied, 317 U. S. 638, rehearing denied, 317 U. S. 706; *Campana Corp.* v. *Harrison,* 135 F. 2d 334 (C. C. A. 7); *Linen Thread Co., Ltd.* v. *Commissioner,* 4 T. C. 802, affirmed, 152

F. 2d 625 (C. C. A. 2); cf. *Argo* v. *Commissioner*, 150 F. 2d 67 (C. C. A. 5), certiorari denied, 326 U. S. 762; *Travelers Ins. Co.* v. *Commissioner*, 161 F. 2d 93 (C. C. A. 2), certiorari denied October 13, 1947, No. 208, present Term. These cases disclose a sound effort to apply the doctrine of *res judicata* in situations involving different tax periods only where the issues are "identical." See Griswold, *Res Judicata in Federal Tax Cases* (1937), 46 Yale L. J. 1320, 1357.

Here, as in the *Engineer's Club* case, *supra*, the facts in the two periods may have been "similar," but "they were a completely different set of events, and they were not the set of events litigated in the earlier cases." 42 F. Supp. 182, 187. Although the ultimate question in both the present case and the prior proceeding relates to taxability of income from royalty contracts assigned to the taxpayer's wife, *none* of the royalty contracts and assignments now before the Court were involved in the earlier case. Moreover, all of the contracts except one (the cylinder grinder contract of 1938) were concerned with patents that were not in issue in the earlier case. Indeed, the two crankshaft grinder patents were not even applied for until 1939 (R. 64). In the circumstances, it seems plain that there is no adequate basis for the application of *res judicata*.

2. A second reason why *res judicata* is inapplicable here is that since the decision of the Board

was promulgated in 1935 in the earlier case, decisions of this Court have been rendered in such important cases as *Helvering* v. *Clifford*, 309 U. S. 331; *Helvering* v. *Horst*, 311 U. S. 112; *Helvering* v. *Eubank*, 311 U. S. 122; *Harrison* v. *Shaffner*, 312 U. S. 579; *Commissioner* v. *Tower*, 327 U. S. 280; and *Lusthaus* v. *Commissioner*, 327 U. S. 293. Since the doctrine of *res judicata* is one that forecloses inquiry into the correct disposition of a case on the merits, it should have no application in tax controversies involving different periods where there are intervening decisions that make clear the error of the earlier decision. In *Blair* v. *Commissioner*, 300 U. S. 5, this Court refused to apply the *Tait* case where there had been an intervening decision of a state court with respect to the character of a particular trust that was the subject matter of both the earlier and subsequent tax proceedings. And since the *Blair* case, the courts have often recognized the principle that *res judicata* does not preclude the correct decision of a tax question for a particular year, if there has arisen since a previous decision a "new situation" created by authoritative intervening decisions with respect to controlling legal principles. See *Corrigan* v. *Commissioner*, 155 F. 2d 164, 165 (C. C. A. 6); *Commissioner* v. *Arundel-Brooks Concrete Corp.*, 152 F. 2d 225, 226–227 (C. C. A. 4); *Commissioner* v. *Security-First Nat. Bank*, 148 F. 2d 937, 940–941 (C. C.

A. 9); *Blaffer* v. *Commissioner*, 134 F. 2d 389, 390 (C. C. A. 5); *Henricksen* v. *Seward*, 135 F. 2d 986 (C. C. A. 9); cf. *Pelham Hall Co.* v. *Hassett*, 147 F. 2d 63, 68–69 (C. C. A. 1); *Gillespie* v. *Commissioner*, 151 F. 2d 903, 906 (C. C. A. 10); *State Farm Ins. Co.* v. *Duel*, 324 U. S. 154, 162; but cf. *Commissioner* v. *Western Union Tel. Co.*, 141 F. 2d 774 (C. C. A. 2), certiorari denied, 322 U. S. 751.

We respectfully submit that although the correct disposition of controversies such as this on the merits should have been foreshadowed by *Lucas* v. *Earl*, 281 U. S. 111, nevertheless the extensive development of the subject through such cases as the *Clifford, Horst, Eubank, Shaffner, Tower,* and *Lusthaus* cases has created a new and different situation. The doctrine of *res judicata* should not apply in a case of this kind where the earlier decision was rendered more than ten years ago, particularly since there is no statutory provision whatever that precludes the correct disposition of a tax controversy for a given year, merely because of a prior erroneous decision involving a different liability for an earlier year. That the prior decision herein in 1935 was erroneous is now amply recognized by the Tax Court itself in this very case. The doctrine of *res judicata* should have no application here.

CONCLUSION

The decision of the Circuit Court of Appeals is unsound. It should therefore be reversed and the decision of the Tax Court reinstated.

Respectfully submitted.

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NOVEMBER, 1947.

APPENDIX

Internal Revenue Code:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—*"Gross income"* includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever * * * (26 U. S. C. 1940 ed., Sec. 22).

SEC. 1141. COURTS OF REVIEW.

(a) *Jurisdiction.*—The Circuit Courts of Appeals and the United States Court of Appeals for the District of Columbia shall have exclusive jurisdiction to review the decisions of the Board,[1] except as provided in section 239 of the Judicial Code, as amended, 43 Stat. 938 (U. S. C., Title 28, § 346); and the judgment of any such court shall be final, except that it shall be subject to review by the Supreme Court of the United States upon certiorari, in the man-

[1] The name of the Board of Tax Appeals was changed to that of The Tax Court of the United States by Section 504 (a) of the Revenue Act of 1942, c. 619, 56 Stat. 798 (26 U. S. C. 1940 ed., Supp. V, Sec. 1100).

ner provided in section 240 of the Judicial Code, as amended, 43 Stat. 938 (U. S. C., Title 28, § 347).

* * * * * *

(c) *Powers.*—

(1) *To affirm, modify, or reverse.*—Upon such review, such courts shall have power to affirm, or, if the decision of the Board is not in accordance with law, to modify or to reverse the decision of the Board, with or without remanding the case for a rehearing, as justice may require.

(26 U. S. C. 1940 ed., Sec. 1141).

(Section 22 (a) of the Revenue Acts of 1938, c. 289, 52 Stat. 447, and of 1936, c. 690, 49 Stat. 1648, is the same as Section 22 (a) of the Internal Revenue Code.)

Treasury Regulations 103, promulgated under the Internal Revenue Code:

SEC. 19.22 (a)–1. *What included in gross income.*—Gross income includes in general compensation for personal and professional services, business income, profits from sales of and dealings in property, interest, rent, dividends, and gains, profits, and income derived from any source whatever, unless exempt from tax by law. (See sections 22 (b) and 116.) In general, income is the gain derived from capital, from labor, or from both combined, provided it be understood to include profit gained through a sale or conversion of capital assets. Profits of citizens, residents, or domestic corporations derived from sales in foreign commerce must be included in their gross income; but special provisions are made for nonresident aliens and for for-

eign corporations by sections 211 to 238, inclusive, and, in certain cases, by section 251, for citizens and domestic corporations deriving income from sources within possessions of the United States. Income may be in the form of cash or property.

* * * * *

Article 22 (a)–1 of Treasury Regulations 101, promulgated under the Revenue Act of 1938, and Article 22 (a)–1 of Treasury Regulations 94, promulgated under the Revenue Act of 1936, are the same.

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